



COMMON MISTAKES IN HOMEWORK SET #6

3) True/False/Uncertain

Part B)

Several people had the following answer(s) for part b:

- The bidders should bid their true reservation price since if they let the bid go lower, there is a chance they will not win the auction.
- If the bidder is risk averse, they should bid their true reservation price.

Solution:

The question is asking what a bidder “*should*” do in this situation. In a Dutch auction, the bidder should “shade down” his bid from his reservation price. Regardless of risk profile, bidders will submit a bid at least somewhat lower than their true bidding price. If the bidder is more risk averse, he will just not shade down as much. Also, even if there is a risk of being out-bid, since all the other players will be shading down, you will bid lower as well.

Part C)

Several people had the following answer(s) for part c:

- False because of adverse selection.

Solution:

Many students argued that the laptop insurance would cause adverse selection. This is NOT the case since the insurance policy requires ALL students to participate in the insurance program regardless of their profiles. Since all students must pay for the insurance through the increase in tuition, students do not opt in to the program.